Statement of Commissioner William S. Haraf
Department of Financial Institutions
March 23, 2011
Joint Informational Hearing
The Dodd-Frank Wall Street Reform and Consumer Protection Act:
Initial Reactions, Initial Steps and Likely Impacts

Good afternoon, Chairman Vargas, Chairman Eng and Committee Members. I am Bill Haraf, Commissioner of Financial Institutions. The Department of Financial Institutions (the Department) licenses and regulates mainly California-chartered banks, credit unions and money transmitters. I am pleased to be here today and to share my thoughts with you regarding Dodd-Frank and its potential impact.

Dodd-Frank is a sweeping piece of legislation that provides a framework for a more active federal regulatory presence in financial markets. It requires federal regulators to implement literally hundreds of new rules over the next several years. Although the legislation does not impose any new mandates on state regulators, it will surely change the landscape for state as well as federal regulation and supervision of financial services. The direct and indirect impacts of Dodd-Frank on the economy, the financial system, and specifically on the Department's licensees and supervisory programs are difficult to foresee. These impacts must also be assessed in the context of other initiatives that the California legislature, the Department and other federal and state regulators are undertaking or may undertake in response to lessons learned from the financial crisis and its aftermath. We must all exercise care to avoid unintended and undesirable consequences for consumers, financial institutions and competition in financial markets.

Many provisions of Dodd-Frank are aimed at the largest banks and nonbank financial institutions whose actions were deemed to be at the heart of the financial crisis. Since the Department's licensees are predominantly smaller financial institutions with closer ties to their communities and customers, the impact of these provisions on the Department's programs and licensees will be manageable.

The future impact of the consumer financial protection title is another matter. The newly established Consumer Financial Protection Bureau (the Bureau) has sweeping authority to write consumer protection rules governing all entities offering consumer financial services or products. Its ultimate impact is likely to be far-reaching, potentially involving increased costs for licensees and greater resource needs for the Department.

The Bureau has examination and enforcement authority for banks, thrifts and credit unions with assets over $10 billion and key non-bank financial services providers (to be defined by Bureau rulemaking). The Department currently has six bank licensees with assets exceeding $10 billion. Prudential regulators, both federal and state, will have primary responsibility for examination of smaller institutions. We, along with state attorneys general, may initiate an enforcement action against a state- or federally-chartered institution with respect to federal consumer financial regulations promulgated by the Bureau.

Dodd-Frank requires the Bureau to collaborate with federal and state prudential regulators and to share consumer complaints. To receive consumer complaints routed from the Bureau, state agencies must have the capability to receive calls and reports from the Bureau and must meet its standards for treatment of personally identifiable information, data security and integrity, and sharing of complaint resolution and compliance information. To that end, the Bureau and the Conference of State Bank

Supervisors negotiated a memorandum of understanding (MOU) to address information-sharing and confidentiality; to promote consistent standards for compliance examinations; and to minimize regulatory burden, particularly for entities licensed and doing business in more than one jurisdiction. I have signed this MOU on behalf of the Department.

Over time, expectations of state-licensed covered entities and state regulators will become clearer as the Bureau's policies and priorities are solidified and rulemaking commences. At my initiative, our Department has already strengthened its processes for receiving, evaluating, tracking and responding to consumer complaints. However, additional resources may be needed to actively participate in compliance examinations and to provide effective supervision under state law.

There has been much discussion of the potential impact from Dodd-Frank's roll-back of the Comptroller of the Currency's authority to preempt the applicability of state laws to national banks. This is likely to be an active arena for court challenges. Preemptive authority remains on a case-by-case basis under a number of conditions specified in the statute: state law would have a discriminatory effect on a national bank; state law would prevent or significantly interfere with the exercise by a national bank of its powers; or state law is specifically preempted by a provision of federal law.

Other provisions of Dodd-Frank will directly or indirectly affect commercial banks and credit unions in a variety of ways. For example: the prohibition on banks paying interest on demand deposits is repealed; debit card interchange fees can be curtailed by the Federal Reserve; the $250,000 deposit insurance limit is made permanent; the FDIC's assessment base for deposit insurance is shifted to one more closely related to total banking assets rather than to domestic deposits; and prohibitions on interstate de novo branching have been eliminated.

The limitation on debit interchange fees, known as the Durbin Amendment, requires the Federal Reserve Board to promulgate regulations to limit the interchange fees issuers may charge retailers to an amount that is “reasonable and proportional.” The rule proposed by the Federal Reserve in December would cap interchange fees at 12 cents per transaction. If implemented as proposed, the cap would substantially reduce fee income for the industry; by some industry estimates by as much as 75%. The proposal has stirred debate regarding costs that should be included in “reasonable and proportional.” This proposal has been controversial, and for good reason: it could do real damage to banks and credit unions that rely on this revenue source. It has prompted a lawsuit by a Minnesota bank challenging its constitutionality. Prominent members of Congress have been critical of the proposed rule saying that it doesn’t reflect the full cost of providing debit cards. Industry representatives and other federal and state regulators have expressed similar concerns.

Other provisions of Dodd-Frank may be similarly challenged as federal regulators meet their responsibilities for writing rules to implement the Act. Thus far, the Department has identified only one provision of Dodd-Frank —elimination of the prohibition on interstate de novo branching — that will require state legislation to conform, but we will continue to monitor implementing federal regulations for conflicts so that conformity may be accomplished in a timely manner.

State-licensed financial institutions overseen by the Department have importantly contributed to the diversity and quality of financial choices that California's households and businesses enjoy. The current economic and financial environment has been challenging for many of them. We all should be mindful that increased regulatory burdens on state-licensed institutions in this environment could add to pressures for industry consolidation and could reduce the number of local choices available to consumers and local businesses.

Before concluding my remarks, I would like to present a brief overview of the Financial Stability Oversight Council (the Council) established by Dodd-Frank. The Council is chaired by Treasury Secretary Timothy Geithner and consists of ten voting and five nonvoting members. The voting members include the heads of all of the federal financial regulatory bodies plus the Treasury Secretary. In addition, by statute the five nonvoting members include a state banking supervisor designated by a selection process determined by state banking supervisors nationwide. I was honored to be selected by my fellow bank supervisors to serve in this role.

The Council is charged with identifying systemic threats to financial stability, promoting market discipline, and responding to emerging risks to financial stability. Among other things, the Council is authorized to: designate significant nonbank financial companies for consolidated supervision by the Federal Reserve; designate systemically significant financial market utilities and payment systems; and recommend stricter supervisory standards for the largest, most interconnected firms and financial market utilities.

The Council is still in the early stages of life, the principals having met only four times thus far, most recently on March 17. We have already completed several statutorily-mandated proposed rules and studies including: a statutorily required study on how best to implement the so-called “Volcker Rule,” which prohibits proprietary trading and certain private fund investments; a study on the impact of the new concentration limits; and a proposed rule outlining the criteria and procedures for designation of systemically important nonbank financial companies and financial market utilities. A great deal of additional work is currently underway through a number of committees and subcommittees. I believe it is fair to say that the establishment of the Council has encouraged a much more robust and healthy dialogue among the participating agencies at all levels and a serious effort to understand and better respond to threats to financial stability.

This concludes my prepared remarks. I will be happy to address any questions you may have.